Audit Report

OFFICE OF THE INSPECTOR GENERAL

QUICK-REACTION AUDIT REPORT ON AN ARRANGEMENT WITH LUXEMBOURG FOR U.S. WAR RESERVE STORAGE AND MAINTENANCE

Report No. 94-046 | February 25, 1994

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Department of Defense

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Acronyms

NATO	North Atlantic Treaty Organization
USAREUR	U.S. Army, Europe, and Seventh Army
WSA	Warehouses Service Agency

INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-2884

February 25, 1994

MEMORANDUM FOR AUDITOR GENERAL, DEPARTMENT OF THE ARMY

SUBJECT: Quick-Reaction Audit Report on an Arrangement with Luxembourg for U.S. War Reserve Storage and Maintenance (Report No. 94-046)

This final report is provided for your information and use. It discusses matters concerning the continuing requirement for the Implementing Arrangement with Luxembourg for storage and maintenance of Army theater reserve stocks. Those matters were disclosed during our ongoing audit of Positioning and Related Storage Requirements for War Reserve Stocks in Europe (Project No. 3RA-0030).

A draft of this report was issued to the Department of the Army on January 31, 1994 with a request for comments to be provided by February 17, 1994 for inclusion in this final report. Comments were not received by the suspense date and therefore could not be incorporated into this report. The urgency in this case is because the Arrangement requires that notice of termination must be provided by April 1, 1994, if operating costs are to be avoided in FY 1995. Therefore, for purposes of expediency, this report and the Army comments are being forwarded directly to the Office of the Assistant Inspector General for Analysis and Followup in accordance with DoD Directive 7650.3 as soon as analysis of those comments is complete.

The courtesies extended to the audit staff are appreciated. If you have any questions on this audit, please contact Mr. Harlan M. Geyer at (703) 692-2830 (DSN 222-2830) or Ms. Evelyn R. Klemstine at (703) 692-2831 (DSN 222-2831). The distribution of this report is listed in Appendix C.

Robert J. Lieberman

Robert J. Lieberman
Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 94-046 (Project No. 3RA-0030.01) February 25, 1994

QUICK-REACTION AUDIT REPORT ON AN ARRANGEMENT WITH LUXEMBOURG FOR U.S. WAR RESERVE STORAGE AND MAINTENANCE

EXECUTIVE SUMMARY

Introduction. In December 1978, the President of Luxembourg and the United States Ambassador to Luxembourg formalized, in a memorandum of understanding, an agreement for the use of two storage sites in Luxembourg. The memorandum of understanding was further defined in Implementing Arrangement DAJA37-84-H-0009. The Army was to use the Luxembourg sites to receive, store, maintain in a ready posture, and issue peacetime operating stocks and pre-positioned theater war reserve material. During our audit of Positioning and Related Storage Requirements for War Reserve Stocks in Europe (Project No. 3RA-0030), we reviewed the continuing requirement for the international agreement with Luxembourg for storage and maintenance of Army theater reserve stocks.

Objectives. The audit objective was to evaluate the continuing requirement for the Implementing Arrangement with Luxembourg for storage and maintenance of Army theater reserve stocks. We also examined applicable internal controls.

Audit Results. The international agreement for theater war reserve storage in Luxembourg no longer supports a valid military requirement. If the U.S. Army, Europe, and Seventh Army, give termination notice before April 1, 1994, operating costs for storage sites could be avoided in FY 1995 and each year thereafter.

Internal Controls. The audit did not review internal controls as they relate to the continuing need for the Luxembourg Implementing Arrangement.

Potential Benefits of Audit. Terminating the Implementing Arrangement should result in potential monetary benefits of $141 million (see Appendix A).

Summary of Recommendations. We recommended that the Army terminate its Implementing Arrangement with Luxembourg for war reserve storage facilities.

Management Comments. Comments were received too late to incorporate them into this report; however, the comments and the audit report will be forwarded to the Office of the Assistant Inspector General for Analysis and Followup as soon as analysis of those comments is complete.

Table of Contents

Executive Summary i

Part I - Introduction 1

Background 2
Objective 2
Scope and Methodology 2
Internal Controls 3
Prior Audits and Other Reviews 3

Part II - Finding and Recommendation 5

Requirement for Luxembourg Facilities 6

Part III - Additional Information 11

Appendix A. Summary of Potential Benefits Resulting from Audit 12
Appendix B. Organizations Visited or Contacted 13
Appendix C. Report Distribution 14

Part I - Introduction

Background

During the mid-1970's, Headquarters U.S. Army, Europe, and Seventh Army (USAREUR), had a critical shortage of storage capacity in Europe for pre-positioned war reserve material. Although 10 million square feet of storage was required, only 2 million square feet was available. To acquire additional facilities, the Army, in consonance with congressional guidance to seek increased host nation support, advised the North Atlantic Treaty Organization (NATO) allies of the need for additional storage capability and requested their assistance. Luxembourg was one of the first countries to offer assistance, and in December 1978, the President of Luxembourg and the United States Ambassador to Luxembourg formalized, in a memorandum of understanding, an agreement for the use of two storage sites in Luxembourg.

The two Luxembourg storage sites designated for use by USAREUR are Bettembourg/Dudelange, which became operational in September 1979, and Sanem, which became operational in September 1984. The mission of the sites was to receive, store, maintain in a ready posture, and issue peacetime operating stocks and pre-positioned theater war reserve material. War reserve material is required to be available during peacetime to meet increased military needs upon the outbreak of war. Pre-positioned theater war reserves are intended to provide essential support to sustain operations during the early stages of a crisis or contingency until resupply capabilities can be established.

On behalf of the government of Luxembourg, the National Credit and Investment Company founded the Warehouses Service Agency (WSA) to build, finance, and manage the storage sites for the Army. WSA was chartered as a corporation on January 15, 1979, with a capital of 40 million Luxembourg francs, 75-percent ownership resting with the government of Luxembourg, and the remaining 25 percent ownership resting with Arbed Steel Corporation. (Arbed Steel Corporation is one of the largest steel mill and manufacturing corporations in Europe.)

Objective

The audit objective was to evaluate the continuing requirement for the Implementing Arrangement with Luxembourg for the storage and maintenance of Army theater reserve stocks.

Scope and Methodology

We examined the memorandum of understanding between the United States and Luxembourg and Implementing Arrangement DAJA37-84-H-0009 for the

storage and maintenance of USAREUR-owned war reserves at the Luxembourg storage facilities. In addition, we reviewed the continuing requirement for the Luxembourg facilities and the FY 1993 contract (Implementing Arrangement DAJA37-84-H-0009). We did not rely on computer-processed data to develop conclusions on this audit.

The audit was made from August through December 1993 at the organizations listed in Appendix B. This program audit was made in accordance with auditing standards issued by the Comptroller General of the United States as implemented by the Inspector General, DoD.

Internal Controls

We did not review the implementation of the Federal Managers' Financial Integrity Act (the Act) as it relates to the continuing need for the Luxembourg Implementing Arrangement. We will assess internal controls and the implementation of the Act in our overall audit of Positioning and Related Storage Requirements for War Reserve Stocks in Europe.

Prior Audits and Other Reviews

In the past 5 years, no audits have specifically addressed the requirement for the Luxembourg storage facilities.

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Part II - Finding and Recommendation

Requirement for Luxembourg Facilities

The international agreement between the United States and Luxembourg for storage sites in Luxembourg no longer supports a valid military mission. Although Headquarters, Department of the Army, has eliminated the requirement for pre-positioning theater reserve stocks, the Army has not terminated Implementing Arrangement DAJA37-84-H-0009. As a result, the United States could pay about $27 million during FY 1995 for the use and services of the Luxembourg facilities.

Implementing Arrangement Terms and Provisions

The memorandum of understanding between the United States and Luxembourg was further defined in Implementing Arrangement DAJA37-84-H-0009. The Luxembourg Implementing Arrangement is a contract that is negotiated and concluded pursuant to the authority of the Luxembourg memorandum of understanding. Implementing Arrangement DAJA37-84-H-0009 defines the logistic support to be provided or received by WSA for the storage and maintenance of USAREUR-owned reserve stocks and other information regarding payments for contractor fees and services. Use of the facilities for FY 1993 cost $27.1 million. The negotiated budgeted costs for FY 1994 are about $27 million.

Implementing Arrangement DAJA37-84-H-0009 is valid indefinitely. Funding for the Implementing Arrangement is done annually through funding orders. By April 15 each year, USAREUR is required to provide an annual workload program for the following fiscal year. WSA is required to submit, by June 1 of the current fiscal year, its budget for the next fiscal year. USAREUR must give its notice of intent to terminate the Implementing Arrangement for the next fiscal year 6 months before expiration of the current funding order. Thus, if USAREUR has not informed WSA by April 1, 1994, of its intent to terminate the Implementing Arrangement, USAREUR will incur the operating expenses of the facilities for another fiscal year.

Requirements for Storage and Maintenance Services

Implementing Arrangement DAJA37-84-H-0009, Annex A, Statement of Services, states that WSA shall provide services in support of USAREUR's theater war reserve mission. The services include, but are not limited to, providing storage and maintenance services to receive, store, secure, care and preserve, inventory, maintain, and issue approximately 120,000 short tons of Army-owned reserve stocks. In addition, WSA is to provide annually up to 135,000 staff hours of equipment repair.

In November 1991, as a result of the Army's reduced force structure in theater and lack of approved funding to support a theater reserve program, the Commander in Chief, USAREUR, requested approval from Headquarters, Department of the Army, to eliminate the requirement for theater war reserves in Europe. In February 1992, Headquarters, Department of the Army, approved the USAREUR request. As a result, the mission of both the Luxembourg sites was eliminated. At the time of our audit, the sites were used for temporary storage of Army theater excess material and equipment designated for the Army's pre-positioned ships program. Despite the changes in mission requirements, USAREUR negotiated FYs 1993 and 1994 contract budgets without a quantified workload statement and the Implementing Arrangement Statement of Services was not amended to reflect the temporary missions. USAREUR has not announced future missions for the Luxembourg sites.

The Implementing Arrangement allows USAREUR to terminate the performance of work when services are no longer needed. WSA is then required to submit to the contracting officer the costs of termination. The actual costs incurred will not be known until the Implementing Arrangement is terminated. We estimated that for the FY 1995 through 2000 Future Years Defense Program, $141 million ($27 million annually less $21 million in severance costs) could be put to better use if the Implementing Arrangement is terminated at the end of FY 1994.

Contract Costs Charged for Storage and Maintenance

At the time the Luxembourg Implementing Arrangement was negotiated, USAREUR storage requirements exceeded in-theater facility availability. To obtain the additional storage needed, USAREUR agreed to reimburse Luxembourg for costs that did not directly support the storage and maintenance operations of the sites, some of which are discussed below. As a result, the arrangement was one of the least cost-effective storage arrangements in Europe. However, because this report recommends termination of the Implementing Arrangement, the report includes no recommendations to renegotiate the accounts discussed below.

Amortization of Building Costs. The Bettembourg/Dudelange and Sanem facilities are NATO constructed projects. During the planning and construction phases of the Bettembourg/Dudelange site, NATO had not decided to finance theater reserve storage sites, and consequently, had not established design criteria. The design specifications of the Bettembourg/Dudelange site, therefore, were based on U.S. Army regulations, which, in many aspects, were more stringent than the criteria NATO finally adopted. As a result, the Bettembourg/Dudelange site was built with some items (for example, a sprinkler system, test-track, fence lighting, and administration building) in excess of NATO criteria. NATO ultimately reimbursed Luxembourg for approximately 81 percent of the construction costs; the remaining 19 percent was to be paid by the United States.

For the Bettembourg/Dudelange site, the U. S. share (19 percent) of construction costs was approximately $8.3 million. However, because no Military Construction, Army, funds had been programmed, USAREUR decided to pay for the project using Operation and Maintenance, Army, funds. The $8.3 million was to be paid in yearly increments over a 20-year period (known as amortization) to the International Bank of Luxembourg. The amortization costs plus a 9.25-percent interest charge (or $9.9 million in interest over the 20-year period) were to be paid as part of the yearly operation costs. Since 1981, Headquarters, USAREUR, has expended about $11.6 million for principle ($3.6 million) and interest ($8 million) on the 19-percent share of costs not reimbursed by NATO. About $4.7 million in principle and $1.9 million in interest remain to be paid.

Remuneration of Working Capital. When WSA was incorporated, Luxembourg law required that a capital investment account be established. To meet the requirements of the law, the government of Luxembourg contributed 30 million Luxembourg francs and Arbed Steel Corporation contributed 10 million Luxembourg francs to a capital investment account. WSA annually charges USAREUR a 7-percent interest rate (or about $85,000) for the use of the contributed 40 million Luxembourg francs. We consider the charge to be a cost for which no verifiable expense is incurred by the contractor. In addition, Federal Acquisition Regulation section 31.205-20 prohibits interest on borrowed funds no matter how they are represented.

Establishment of a Legal Reserve Fund. Luxembourg law requires corporations to establish a legal reserve fund. To establish a legal reserve fund, WSA annually bills USAREUR 5 percent of 40 million Luxembourg francs in a capital investment account, or 200,000 Luxembourg francs ($6,000). The legal reserve funds are then accumulated from year to year on the balance sheet of WSA's financial statements. As of September 30, 1993, the WSA balance sheet showed 2,685,161 Luxembourg francs ($81,000) maintained in the reserve fund. We consider the 5-percent charge a cost that does not directly support the storage and maintenance operations of the sites.

WSA Charges for Property Tax. The Implementing Arrangement states:

> ...that WSA warrants that the costs charged to the U.S., including the prices in subcontracts, do not include any tax or duty which the United States Government and the Government of Luxembourg have agreed shall not be applicable to expenditures in Luxembourg by the United States, or any other tax or duty not applicable to this Implementing Arrangement under the laws of Luxembourg. If any such tax or duty has been included in the Implementing Arrangement prices through error or otherwise, the Implementing Arrangement prices shall be correspondingly reduced, and the amounts paid toward taxes reimbursed with interest from their date of payment.

NATO does not pay property tax on its 81-percent share of the construction costs for the Bettembourg/Dudelange storage site. However, in FY 1993, WSA charged USAREUR $11,000 in property taxes for USAREUR's 19-percent share of construction costs. Budgeted costs for FY 1994 property taxes are $10,753. Since NATO does not pay property taxes and the Implementing Arrangement excludes taxes, USAREUR should not pay the FY 1994 charges.

WSA Charges for Morale Support. One of the responsibilities of WSA is to support cultural and sports associations for its employees. Article 4, section F of the Implementing Arrangement lists morale support as an allowable cost; however, no formal definition of that cost is in the Arrangement. In FY 1993, WSA billed USAREUR $7,830 for morale support. Examples of items USAREUR reimbursed WSA for included repair of musical instruments, basketballs, soccer balls, and uniforms for the band, soccer, and bowling teams. The FY 1994 budget has planned $8,789 for morale support. Since the morale support account does not directly support the storage and maintenance operations of the sites, we contend that it should not be an allowable cost to USAREUR.

Need for the WSA's Board of Directors. Ten members are on the board of directors of WSA. Seven members are nominated by the National Credit and Investment Company, and three are nominated by Arbed Steel Corporation. The Chairman of the Board is the Luxembourg Ambassador of Foreign Affairs; the vice-chairman is a member nominated by Arbed Steel Corporation. One of the main functions of the board is to receive and review WSA's monthly costs. The board meets once or twice a month. For FY 1993, USAREUR was billed $37,980 for the board of directors' meetings. Budgeted costs for FY 1994 are $38,383. We question the need for a board of directors considering that WSA manages only one contract and that all proposed purchases of more than $50.00 must be approved by the Army contracting officer's representative.

Recommendation, Management Comments, and Audit Response

We recommend that the Commander in Chief, U.S. Army, Europe, and Seventh Army, terminate Implementing Arrangement DAJA37-84-H-0009.

Management Comments. Comments on the draft of this report were received on February 22, 1994, which was too late to incorporate them into this report; however, the comments and the audit report will be forwarded to the Office of the Assistant Inspector General for Analysis and Followup when analysis of those comments is complete.

Audit Response. Should the Department of the Army wish to provide additional comments on this audit report, the comments should be provided to the Assistant Inspector General for Analysis and Followup, Office of the Inspector General, DoD.

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Part III - Additional Information

Appendix A. Summary of Potential Benefits Resulting from Audit

Description of Benefit from Implemented Recommendation	Amount and/or Type of Benefit
Economy and Efficiency. Eliminates payment for storage sites that no longer have a supportable mission.	Amount: $141 million ($27 million annually for FYs 1995 through 2000, minus $21 million for severance costs) Total benefits are subject to determination of final termination costs. Type: funds put to better use Appropriation: 21X2020 - Operation and Maintenance, Army

Appendix B. Organizations Visited or Contacted

Department of the Army

Office of the Deputy Chief of Staff for Logistics, Headquarters, Department of the Army, Washington, DC
Headquarters, U.S. Army, Europe, and Seventh Army, Heidelberg, Germany
Headquarters, 266th Theater Finance Center, Heidelberg, Germany
Headquarters, 21st Theater Army Area Command, Kaiserslautern, Germany
Headquarters, 29th Area Support Group, Kaiserslautern, Germany
Reserve Storage Activity, Bettembourg, Luxembourg
Headquarters, U.S. Army, Europe, and Seventh Army Contracting Center, Frankfurt, Germany

Unified Command

Headquarters, U.S. European Command, Patch Barracks, Stuttgart-Vaihingen, Germany

Appendix C. Report Distribution

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Audit Team Members

William F. Thomas	Director, Readiness and Operational Support Directorate
Harlan M. Geyer	Audit Program Director
Evelyn R. Klemstine	Audit Project Manager
Anella J. Oliva	Senior Auditor
Robert L. Kienitz	Auditor
Nancy C. Cipolla	Editor

16

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